Office - Supreme Court, U. S.
FILED
OCT 2 1944
CHARLES ELMORE CROPLEY
CLERK

IN THE

Supreme Court of the United States

October Term, 1944.

IRVING AIR CHUTE COMPANY, INC.,
Petitioner,
against
COMMISSIONER OF INTERNAL REVENUE,
Respondent.

No. 533

PETITION FOR WRIT OF CERTIORARI.

RALPH M. ANDREWS,
DANIEL G. YORKEY,
Counsel for Petitioner,
1330 Marine Trust Building,
Buffalo 3, New York.

BATAVIA TIMES, LAW PRINTERS,
BATAVIA, N. Y.

INDEX.

PAGE

Opinions Below 2

Jurisdiction 2

Statute Involved 2

Question Presented 3

The Facts 3

The United Kingdom Law 5

Reasons for Granting the Writ 9

I. The decision below conflicts in principle with recent decisions of this Court 9

II. A question of importance in the administration of the revenue laws is presented 18

Conclusion 19

II.

Citations.

PAGE

Cases:

Alexander Smith & Sons Carpet Co. v. Commissioner, 117 F. (2d) 974 ..... 15n.

Biddle v. Commissioner, 302 U. S. 573 ..... 11, 13, 15

Commissioners of Inland Revenue v. Cull, 22 Tax Cases, 603, 636 11

Commissioners of Inland Revenue v. Dalgety & Co., Ltd., [1930] 1 K. B. 1, and (H. L.) 46 T. L. R. 349; 15 T. C. 216 ..... 13n.

Commissioners of Inland Revenue v. Sangster, [1920] 1 K. B. 587; 12 T. C. 208 12

Constantinesco v. Rex, 11 T. C. 730; 43 T. L. R. 727 .. 12

Crawford Music Corporation, 40 B. T. A. 284 .. 14, 15, 16, 17

Hamilton, F. H., v. Commissioners of Inland Revenue, 16 Tax Cases, 213 11

International Harvester Co., *et al.* v. Wisconsin Department of Taxation, ...U. S....., 64 Sup. Ct. 1060 13

Lanston Monotype Corporation, Ltd. v. Anderson, [1911] 2 K. B. 1019, 5 Tax Cases, 675 7

Neumann v. Commissioners of Inland Revenue, 18 Tax Cases, 332, 362 11

New Consumers' Bread Co. v. Commissioner, 115 F. (2d) 162 ..... 15n.

Wild v. Ionides, 9 T. C. 392 12

Wisconsin Gas & Electric Co. v. United States, ... U. S. ...., 64 Sup. Ct. 1106 ..... 9, 10, 11

PAGE

United States Statutes:

Act of February 13, 1925, 43 Stat. 940 (28 U. S. C. A. Sec. 350) 2
Current Tax Payment Act of 1943..... 12
Judicial Code, Sec. 240(a) (28 U. S. C. A. Sec. 347(a)) 2
Revenue Act of 1934
Sec. 23(c) 9
Sec. 131 .....2, 3, 4, 9, 16, 18

United Kingdom Statutes:

Emergency Powers (Defense) Act, 1939 (2 and 3 Geo. VI, Ch. 62, Section 1) .....18n.
Income Tax Act, 1918
Sec. 1 5
General Rule 19(2) 4, 5, 6, 7, 14, 20
General Rule 20 20
General Rule 21 .....6, 7, 14, 15, 20
Rule 3(m) 6, 7, 20
Regulation 3-C of Defense (Finance) Regulations, 1939 (Statutory Rules and Orders, 1939, No. 1620) .18n.

Rulings:

1940-1 C. B. 2 14

IN THE

Supreme Court of the United States

October Term, 1944.

IRVING AIR CHUTE COMPANY, INC.,
Petitioner,
against
COMMISSIONER OF INTERNAL REVENUE,
Respondent.

No. .....

PETITION FOR WRIT OF CERTIORARI.

To the Honorable the Chief Justice of the United States and the Associate Justices of the Supreme Court of the United States:

Irving Air Chute Company, Inc., the petitioner above named, prays that a writ of certiorari issue to the United States Circuit Court of Appeals for the Second Circuit to review a judgment of that Court made in the above case July 3, 1944 (R. 181), affirming a decision of The Tax Court of the United States (R. 160) that there is a deficiency in the income tax of the petitioner for the calendar year 1935.

This petition is made because of a conflict between the decision below and decisions of this Court handed down at about the same time but not considered by the Circuit

Court, and for the further reason that a question is presented of great importance in the administration of the federal internal revenue laws.

Opinions Below.

The opinion of The Tax Court of the United States (Judge Arundell) appears in the record at pages 143, *et seq.*, and is reported in 1 T. C. 880. The opinion of the Circuit Court of Appeals, Second Circuit (Judges Chase and Frank) appears in the record at pages 174, *et seq.*, and is reported in 143 F. (2d) 256. The dissenting opinion of Judge Learned Hand appears in the record at page 180 and is reported in 143 F. (2d) 256, at 260.

The judgment of the United States Circuit Court of Appeals, Second Circuit, affirming the order of The Tax Court of the United States and further ordering that a mandate issue accordingly was made and filed July 3, 1944 (R. 181, 182).

Jurisdiction.

The jurisdiction of this Court is invoked under Section 240(a) of the Judicial Code, as amended (28 U. S. C. A. Sec. 347(a)) and under Section 8 of the Act of February 13, 1925, 43 Stat. 940, c. 229 (28 U. S. C. A. Sec. 350).

Statute Involved.

The statute under which this case arises is Section 131(a) of the Revenue Act of 1934, 48 Stat 680, (26 U. S. C. A., Internal Revenue Acts, 659, at 713) which reads in part as follows:

"§ 131. TAXES OF FOREIGN COUNTRIES AND POSSESSIONS OF UNITED STATES.

"(a) Allowance of Credit.—If the taxpayer signifies in his return his desire to have the benefits of this section, the tax imposed by this title shall be credited with:

"(1) Citizen and domestic corporation.—In the case of a citizen of the United States and of a domestic corporation, the amount of any income, war-profits, and excess-profits taxes paid or accrued during the taxable year to any foreign country or to any possession of the United States; * * * "

Question Presented.

The only question presented by this case is whether certain amounts deducted pursuant to the British Income Tax Acts from patent royalties accrued to petitioner from a British company constitute "income * * * taxes paid or accrued during the taxable year to any foreign country," thus entitling petitioner to a credit under Section 131(a) (1) of the Revenue Act of 1934.

The Facts.

Petitioner, a New York corporation, was the owner of certain British letters patent relating to airchutes and parachutes (R. 15). It granted exclusive licenses under these patents to an English company, petitioner's wholly owned subsidiary, in consideration, among other things, of the payment of a royalty of 12 per cent on the sale price of each chute sold by the English company (R. 15-17).

During the calendar year 1935, the English company sold a large number of chutes under the licenses, upon which the royalties due to petitioner, computed at the contract

rate of 12 per cent, amounted to $113,546.20 (R. 17, 18). The English company, when it paid these royalties to petitioner, deducted and withheld therefrom taxes amounting to $25,547.88 pursuant to Schedule D and General Rule 19(2) of the British Income Tax Act, 1918, as amended (R. 18). (These provisions of the United Kingdom law are fully set out and discussed immediately following this statement of facts.)

The question in this case is whether such taxes, which accrued during the year 1935 on the royalties earned on that year's sales, and which were deducted and withheld upon payment of the royalties, are petitioner's taxes "accrued during the taxable year to any foreign country" within the meaning of Section 131 (a) of the Revenue Act of 1934.

Petitioner kept its books of account and filed its United States income tax returns on the calendar year and accrual basis (R. 20). In its return for 1935, petitioner signified its desire to have the benefit of the credit provided by Section 131 (a) (R. 20, 21). It filed with its return Treasury Form 1118 on which it claimed $25,347.53 as a credit against its income tax for the year 1935, after application of the limitation upon the credit imposed by Section 131 (b) (R. 20, 21).

The Commissioner, in his notice of deficiency (R. 9), denied petitioner's claim for credit against its domestic tax liability and held that petitioner's income from royalties from the British company should be adjusted to reflect the net amount received, *i. e.*, the amount of $87,998.32 (R. 21). (The same issue is presented with respect to petitioner's tax liability in each year subsequent to 1935 and in one form or another awaits the outcome of this case.)

The United Kingdom Law:

Income tax in Great Britain is charged by Section 1 of the Income Tax Act, 1918, and the Finance Act of each particular year (R. 38, 39). The Finance Act of the year prescribes that income tax shall be charged for that year and the rate at which it is to be charged (R. 39). The basic Act, however, is the Income Tax Act, 1918 (R. 43, 44).

Section 1 of the 1918 Act provides that a tax charged by any Finance Act shall be effective on all "property, profits, or gains respectively described or comprised in the schedules marked A, B, C, D, and E, contained in the First Schedule to this Act and in accordance with the Rules respectively applicable to those Schedules" (R. 44, 45). Sections 1 and 2 of Schedule D provide that tax shall be charged under Schedule D in respect of the annual profits or gains arising or accruing to any person, although not resident in the United Kingdom, from any property whatever in the United Kingdom, in accordance with the rules applicable (R. 45). A British patent is property in the United Kingdom and royalty payments are annual profits or gains arising or accruing from such property (R. 49, 50, 86).

British income tax is collected whenever possible by withholding at the source (R. 94). The withholding provisions are contained in the General Rules applicable to the various schedules under the Income Tax Act, 1918. These General Rules, so far as pertinent, are printed in an appendix at the end of this petition *(infra*, pp. 20-21).

Where a royalty is paid wholly out of profits or gains of the payor, General Rule 19(2) applies. It provides that "the person paying the royalty or sum shall be entitled,

on making the payment, to deduct and retain thereout a sum representing the amount of the tax thereon at the rate or rates of tax in force during the period through which the royalty or sum was accruing due."

A complementary provision is Rule 3(m) of the Rules applicable to Cases I and II of Schedule D, which provides that "in computing the amount of the profits or gains to be charged, no sum shall be deducted in respect of * * * any royalty or other sum paid in respect of the user of a patent."

Thus, if the royalty is payable wholly out of the payor's profits or gains, he deducts and withholds the tax thereon, which is later collected by the Crown from the payor when his own income tax is computed and paid through the device of refusing him a deduction for royalties paid. (R. 61, 69-70, 92-3, 97.)

On the other hand, if the royalty is not payable or not wholly payable out of the payor's profits or gains, General Rule 21(1) applies. It provides that "the person by or through whom any such payment is made shall deduct thereout a sum representing the amount of the tax thereon at the rate of tax in force at the time of the payment." The payor then accounts to the Crown specially for the tax so withheld. (R. 61, 69-70, 92-3, 97.)

Usually, at the time the royalties are paid the payor is in doubt as to whether the deduction of income tax should be made under General Rule 19(2) or General Rule 21(1). The result is that he invariably deducts the tax, knowing that he might have to account for it specially to the Revenue under General Rule 21(1). The question whether the deduc-

tion is made under Rule 19(2) or under Rule 21 is entirely a matter between the payor and the Commissioners of Inland Revenue. The difference between the two Rules may be stated in this way: If the deduction is made under Rule 19 the payor will account for the tax by the royalty being included in the assessment of his own income through his not being allowed to deduct it by reason of Rule 3(m) of the Rules applicable to Cases I and II of Schedule D, whereas if Rule 21 applies the payor has to account to the Revenue by paying over specially the amount of tax deducted. He must, under Rule 21(2), deliver an account of the payment to the Commissioners of Inland Revenue, and the Special Commissioners will immediately assess and charge the payment and collect the tax from the payor under such assessment (R. 61).

In this case the royalties were paid out of the profits or gains of the British company. Hence, the procedure prescribed by General Rule 19(2) and Rule 3(m) was followed. Since the company, in preparing its commercial accounts in the normal way, had treated the royalties as an expense, it was necessary that these should be added back in computing its profits for the purposes of assessment under Schedule D. The "adding back" of the royalties to the company's assessment is the machinery for enabling the Crown to obtain from the company the tax which the company deducted under General Rule 19(2) on paying the royalties to the petitioner (R. 69, 70).

Speaking of General Rule 19(2), Lord Justice Farwell, in his judgment in the Court of Appeal in the case of *Lanston Monotype Corporation, Ltd. v. Anderson*, [1911] 2 K. B. 1019, 5 Tax Cases, 675 (Petitioner's Exhibit 19), said: "I think it is plain that this is a mere collecting section for

the improvement of the machinery for collecting the tax, and not a charging section at all" (R. 49; Petitioner's Exhibit 19, p. 683). And Lord Justice Kennedy on the same Court and in the same case said: "It seems to me * * * the true view is * * * that the object of the Section is to provide for the tax on payment of the royalties by deduction" (R. 49; Petitioner's Exhibit 19, p. 684).

Reasons for Granting the Writ.

I. The decision below conflicts in principle with recent decisions of this Court.

In *Wisconsin Gas & Electric Company v. United States*, ... U. S. ..., 64 Sup. Ct. 1106 (October Term, 1943, No. 565, May 29, 1944), decided after this case was briefed and argued in the Circuit Court and approximately two weeks before that Court's decision in this case (June 15, 1944), the question was whether a corporation was entitled to a deduction under Section 23(c) of the Revenue Act of 1934 for taxes paid under the Wisconsin Privilege Dividend Tax Act with respect to dividends paid to its stockholders. The Wisconsin statute required the paying corporation to deduct and withhold the tax from dividends paid to its stockholders and thereafter to return and pay the tax to the Commission.

The *Wisconsin* case and the instant case are remarkably similar. The sections of the law under which they arose, Sections 23(c) and 131(a), are substantially identical in language, except that one provides for a deduction from gross income of the amount of "taxes paid or accrued during the taxable year," whereas the other provides for a credit against the tax.

In the Wisconsin case this Court made the result turn upon "whether the Privilege Dividend Tax is 'imposed' upon the corporation declaring the dividends." Looking at the Wisconsin law it found the tax "is imposed upon the shareholder, not upon the corporation" and concluded, therefore, that the tax payments were not deductible by the corporation.

In the present case the Tax Court did not regard as material the question of the person upon whom the tax was imposed, because, it said, "The fact of liability to income tax in and of itself does not justify a credit," (1 T. C. 880, at 891; R. 159) ignoring the rule upon which this Court later was to found its decision in the *Wisconsin* case and forgetting that petitioner is on the accrual basis and that liability for the tax necessarily was the event which fixed the accrual.

The parallel between the cases becomes complete if we apply to the present case the following paragraph from the *Wisconsin* opinion (64 Sup. Ct. 1106, at 1108):

> "That Wisconsin has made the corporation its tax collector by requiring it to withhold payment of a portion of the dividends and to turn that portion over to the State does not make the tax one 'imposed' upon the corporation, at least under Section 23(c) and the relevant Treasury Regulation. Compare Eliot Nat. Bank v. Gill, 218 F. 600 (CCA 1st); Porter v. United tSates, 27 F. (2d) 882 (CCA 9th). The fact is that the tax is extracted from fixed dividends owed to the stockholder, not merely from his common interest in corporate earnings. Under Wisconsin decisions the impact of the tax is focused narrowly and falls independently upon each recipient of the dividend without affecting the tax burden of the corporation or other shareholders. The operation thus disclosed for the tax amply sustains the emphatic declaration of the Wisconsin Supreme Court that it is imposed upon the shareholder, not upon the corporation. * * *"

Here, the United Kingdom has made the British payor of the royalties its tax collector by requiring it to withhold payment of a portion of the royalties and to turn that portion over to the Crown. If the British payor has an income tax of its own to pay, it simply adds the withheld tax to its own. If it does not have a tax of its own, it pays over the amount withheld just the same. This—to

paraphrase the *Wisconsin* opinion—does not make the tax one "imposed" upon the payor. The fact is that the tax is extracted from fixed royalties owed the licensor. *Under United Kingdom law, the impact of the tax falls independently upon each recipient of royalties without affecting the tax burden of the payor.*

There is no indication that the Circuit Court in the instant case saw or considered the *Wisconsin* decision. If it had, it is inconceivable that it would have decided this case as it did. The principles of the two cases are irreconcilably in conflict.

Furthermore, the decision below misapplies this Court's decision in *Biddle v. Commissioner*, 302 U. S. 573 (1938). As Judge Hand stated, that case involved the question whether "when a corporation deducted on the face of its dividend the shareholder's proportion of the tax levied on the corporate income, the shareholder paid the tax," thus entitling him to a credit under Section 131 (a). *The fact is that dividends are not taxed under the United Kingdom Law. Neumann v. The Commissioners of Inland Revenue*, 18 Tax Cases, 332, 362 (1934) (Petitioner's Exhibit 18); *F. H. Hamilton v. The Commissioners of Inland Revenue*, 16 Tax Cases, 213 (1931); *The Commissioners of Inland Revenue v. Cull*, 22 Tax Cases, 603, 636 (1940) (Petitioner's Exhibit 17); R. 56-58, 79-82. This Court accepted this conclusion in the *Biddle* case (p. 579) and accordingly denied the credit to the shareholder, just as in the *Wisconsin* case it denied a deduction to the corporation after finding that the tax was imposed upon the shareholders. The test, therefore, should have been, upon whom is the tax imposed?

The application of this test to the present case goes to the heart of the problem. The real difficulty with the Cir-

cuit Court's decision is that it ignores the fact that royalty income is income from property which is specifically taxed under Schedule D. It is not realistic to suppose that the British impose a tax and fail to collect it. The notion that the licensor's tax is collected from the licensee is equally unrealistic. *The British Act, like ours, taxes income received, not income expended, so that one would expect to find the recipient, not the payor, the taxpayer.* The fact is that under the British system the licensee acts as a collecting agent for the Crown in the same manner as the corporation under the Privilege Dividend Tax Act in the *Wisconsin* case (and, incidentally, in the same manner as the employer under the Current Tax Payment Act of 1943).

The British law imposes a tax upon all income arising from "any property whatever in the United Kingdom" (Section 1, Schedule D). Income from royalty agreements is income from property under this provision. *The Commissioners of Inland Revenue v. Saugster*, [1920] 1 K. B. 587; 12 T. C. 208. The tax is collected by deduction under authority of General Rules 19(2) and 21 of the Income Tax Act, 1918 (R. 46), both of which describe the amount to be deducted as "*the amount of the tax thereon*," *i. e.* on the royalties. *Failure of the payor to deduct the tax upon payment permits the Crown to make a direct assessment against the payee, Wild v. Ionides*, 9 T. C. 392 (Petitioner's Exhibit 15); *Constantinesco v. Rex*, 11 T. C. 730; 43 T. L. R. 727 (Petitioner's Exhibit 16) (R. 50, 51). The record in this case is clear and the evidence is undisputed that the United Kingdom tax is on the royalties and is the liability of the recipient thereof. The language of the statute, the British decisions and the testimony of the expert witness are all to this effect. In his dissenting opinion Judge Hand

clearly recognized that the tax in question was a tax upon the royalties.[1]

The Court below not only misapplied the *Biddle* case; it violated the underlying principle upon which it was decided. In that case this Court had said (302 U. S. 573, at 579):

> "That [the question as to who is the taxpayer] must ultimately be determined by ascertaining from an examination of the manner in which the British tax is laid and collected what the stockholder has done in conformity to British law and *whether it is the substantial equivalent of payment of the tax as those terms are used in our own statute.*" (Italics added.)

This Court stated the rule in a different but equally forceful way in *International Harvester Co., et al. v. Wisconsin Department of Taxation*, ... U. S. ....., 64 Sup. Ct. 1060, at 1063 (October Term, 1943, Nos. 620, 621, May 29, 1944):

> "For present purposes we assume that the statute, by directing deduction of the tax from declared dividends, distributes the tax burden among the stockholders differently than if the corporation had merely paid the tax from its treasury and that the tax is thus, *in point of substance, laid upon and paid by the stockholders*, some of whom might not bear the burden of the tax at all if, without more, it were paid out of the corporate treasury. This is obviously the case here with respect to the deductions from dividends on appellant Harvester's preferred stock, since normally the economic weight of taxes paid by the corporation would be borne by its common stockholders." (Italics added.)

---

[1] For some unexplained reason the majority of the Circuit Judges seems to have read the *Dalgety case (Commissioners of Inland Revenue v. Dalgety & Co., Ltd.*, [1930] 1 K. B. 1, and (H. L.) 46 T. L. R. 349; 15 Tax Cases, 216) (involving the tax on interest) as holding otherwise in spite of the fact that the judgment of Lord Justice Warrington in that case plainly referred to the tax as "the tax payable by the recipient" (R. 110, 111). In the judgment of Lord Hanworth it is said: "The tax deducted is the tax that is due from the person to whom the interest is paid" (R. 102). Judge Hand correctly analyzed the *Dalgety* case in his dissenting opinion.

The Court below not only completely ignored the rule thus laid down by this Court, but exalted form over substance and made the decision turn upon the British machinery of collection (General Rule 19(2)) which, not being a taxing section, sheds no light whatever upon the question of the person upon whom liability for the tax rests. We respectfully submit that the record in this case may not be read without coming to the conviction that what this petitioner did was "the substantial equivalent of payment of the tax as those terms are used in our own statute" and that "in point of substance" the tax was laid upon and paid by petitioner.

Having rested its decision upon the peculiar form and language of General Rule 19(2) which provides the collection machinery in cases where the payor has profits or gains out of which the royalties could have been paid, the Court was confronted with the necessity of reconciling the situation which arises under General Rule 21(1), which provides for withholding the tax where the payor is without profits or gains. Even the Circuit Court was unwilling to accept the distinction made by the Tax Court between these two situations.

In *Crawford Music Corporation*, 40 B. T. A. 284 (1939), in which the Commissioner has acquiesced (1940-1 C. B. 2), the Tax Court (then the Board of Tax Appeals) was confronted with the propriety of a credit claimed by the taxpayer on account of the deduction of United Kingdom income taxes from copyright royalties paid to it from English sources. The provision of the United Kingdom Income Tax Act pursuant to which tax on copyright royalties paid to non-residents of the United

Kingdom is deducted is General Rule 21, which is the same Rule applicable to deduction of tax from patent royalties paid out of other than gains or profits of the payor. The Board held that the taxpayer was entitled to the credit which it claimed, saying in part (49 B. T. A. 284, at 290):

> "It seems plain, however, from a reading of the British income tax acts, quoted in material part above, that the person who pays United Kingdom income tax upon the royalties of petitioner pays those as the taxes of the petitioner * * *."

The combination of the Tax Court's decisions in the instant case and the *Crawford* case meant that the credit of the American licensor was made to depend entirely upon whether the British payor of the royalties had profits or gains within the technical concept of the United Kingdom law. The Circuit Court declined to accept this "shifting standard" specifically decried by this Court in the *Biddle* decision. Having thus rejected the principle upon which the Tax Court had proceeded, the majority of the Circuit Judges allowed themselves to be driven to a different but equally untenable position. The majority held that the effect of the British law is not to impose a tax upon petitioner, but simply to make the royalty contract—

> "* * * so elastic[2] that the licensee is permitted to reduce the amount of petitioner's income receivable

[2] The assumption by the majority of the Circuit Court that an analogy in support of their decision is to be found in *New Consumers Bread Co. v. Commissioner*, 115 F. (2d) 162 (1940) and *Alexander Smith & Sons Carpet Co. v. Commissioner*, 117 F. (2d) 974 (1941) is plainly fallacious. Those cases involved refunds of processing taxes levied under the Agricultural Adjustment Act. Congress had denied the refund to all taxpayers except those who had directly paid the tax and had not been reimbursed. In the cases cited the processers had paid the tax but had passed it on to the claimants in the form of increased prices. It was held that the claimants were not entitled to refund because the incidence of and liability for the tax was upon the processers and because the claimants had borne the tax only indirectly.

> as royalties under it. The British law has made its license agreements less valuable as income producing contracts than they otherwise would have been, and perhaps the worth of its patents has been decreased; but those results are brought about not because under our concept of taxation any income of this petitioner has been taxed but because a foreign taxpayer has been given the right to recoup from royalties it would otherwise have had to pay the petitioner in full, the amount which its own government has elected to tax it instead of the petitioner, not exactly on its royalty payments to petitioner but by reason of them" (R. 179; 143 F. (2d) 256, at 259-60).

This extraordinary reasoning leads to two serious results which seem to us to call for the granting of a writ in this case.

First, if the net result of the United Kingdom law is in effect simply to make the royalty contract elastic and permit the British payor to reduce the amount of petitioner's royalties under the contract, then necessarily the Court's decision is a judicial repeal of Section 131(a) of the Revenue Act of 1934 and the corresponding sections of subsequent Revenue Acts and the Code, insofar as an American citizen's income from the United Kingdom from royalties and many other types of contractual arrangements is concerned.

Second, the Court's conclusion that "the same result would follow whether the licensee paid the tax under General Rule 19 or accounted to the Crown under General Rule 21 for the amount it withheld from its royalty payments" (R. 179-80; 143 F. (2d) 256, at 260) in effect overrules *sub silentio* the *Crawford* case, which has been accepted by the Commissioner and followed administratively for four years.

The *Crawford* case is disposed of by inference as to taxpayers residing within the jurisdiction of the Second Circuit, although it may retain its force as to taxpayers residing in other Circuits. It is sufficient to say that the confusion in this field of the law is now complete. It presents an open invitation to controversy and tax litigation.

II. A question of importance in the administration of the revenue laws is presented.

As has already been pointed out, the result of the decision below is in effect to repeal Section 131(a) insofar as it may be applied to many types of income of American taxpayers from British sources, and to throw into utter confusion the status of the credit arising in that large body of cases which otherwise would be controlled by the *Crawford* case and the administrative practice which followed in the wake of the Commissioner's acquiescence.

The question raised by this case is in itself difficult. It is one which should be settled by this Court. In its opinion the Tax Court conceded that "the question is not free from difficulty." The decision in the Circuit Court was divided, Judge Learned Hand dissenting in a well-reasoned and carefully considered opinion (143 F. (2d) 256, at 260; R. 180).

The question is one which is of importance in the administration of the revenue laws, if only because of the large number of cases now pending which will turn upon and be controlled by the outcome of the instant case. Some of these cases are pending in the Tax Court of the United States. A great many others are pending on waivers in the Bureau of Internal Revenue, and still others on claims for refund.

The question is of growing importance to the revenue. With the cessation of hostilities and the removal of restrictions on the exportation of funds from the United Kingdom, the question will loom large indeed.[3]

---

[3] Exportation of funds from the United Kingdom is now blocked. Emergency Powers (Defence) Act, 1939 (2 and 3 Geo. VI, Ch. 62, Section 1) authorized defence regulations to be made by an order in council. Regulation 3-C of Defence (Finance) Regulations, 1939 (Statutory Rules and Orders, 1939, No. 1620) forbids any person except with permission of the Treasury to make any payment to or place any sum to the credit of any person resident outside of the sterling area.

Conclusion.

For the reasons set out herein a writ of certiorari to the Circuit Court of Appeals for the Second Circuit to review its decision in this case should be granted.

Respectfully submitted,

RALPH M. ANDREWS,
DANIEL G. YORKEY,
Counsel for Petitioner.

APPENDIX.

General Rules Applicable to Schedules A, B, C, D and E, The Income Tax Act, 1918

"19.—(1) * * * * *

"(2) Where any royalty, or other sum, is paid in respect of the user of a patent, wholly out of profits or gains brought into charge to tax, the person paying the royalty or sum shall be entitled, on making the payment, to deduct and retain thereout a sum representing the amount of the tax thereon at the rate or rates of tax in force during the period through which the royalty or sum was accruing due.

"20. The profits or gains to be charged on any body of persons shall be computed in accordance with the provisions of this Act on the full amount of the same before any dividend thereof is made in respect of any share, right or title thereto, and the body of persons paying such dividend shall be entitled to deduct the tax appropriate thereto.

"21.—(1) Upon payment of any interest of money, annuity, or other annual payment charged with tax under Schedule D, or of any royalty or other sum paid in respect of the user of a patent, not payable, or not wholly payable, out of profits or gains brought into charge, the person by or through whom any such payment is made shall deduct thereout a sum representing the amount of the tax thereon at the rate of tax in force at the time of the payment.

"(2) * * * * *"

Rules Applicable to Cases I and II of Schedule D

"3. In computing the amount of the profits or gains to be charged, no sum shall be deducted in respect of—

* * * * *

"(m) any royalty or other sum paid in respect of the user of a patent."

INDEX

	Page
Opinions below	1
Jurisdiction	1
Question presented	2
Statute and regulations involved	2
Statement	4
Argument	7
Conclusion	11

CITATIONS

Cases:	
Biddle v. *Commissioner*, 302 U. S. 573	8, 9, 11
Crawford Music Corp. v. *Commissioner*, 40 B. T. A. 284	10
Dalgety & Co., Ltd. v. *Commissioners of Inland Revenue*, 15 British Tax Cases 216	9
International Standard Electric Corp. v. *Commissioner*, 1 T. C. 1153, affirmed August 11, 1944	10
Trico Products Corp. v. *Commissioner*, 46 B. T. A. 346, affirmed, 137 F. 2d 424, certiorari denied, 320 U. S. 799	10
Welch v. *St. Helens Petroleum Co.*, 78 F. 2d 631	9
Wisconsin Gas and Electric Co. v. *United States*, decided May 29, 1944	7, 9
Woolworth, F. W., Co., v. *United States*, 91 F. 2d 973, certiorari denied, 302 U. S. 768	9
Statutes:	
British Income Tax Act of 1918, 8 and 9 Geo. V, c. 40, Sec. 1	5
Revenue Act of 1934, c. 277, 48 Stat. 680, Sec. 131	2
Miscellaneous:	
Treasury Regulations 86, promulgated under the Revenue Act of 1934:	
Art. 131–2	3
Art. 131–3	3

614287—44

In the Supreme Court of the United States

OCTOBER TERM, 1944

No. 533

IRVING AIR CHUTE COMPANY, INC., PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

OPINIONS BELOW

The opinion of the Tax Court (R. 143–159) is reported in 1 T. C. 880. The opinion of the circuit court of appeals (R. 174–181) is reported in 143 F. 2d 256.

JURISDICTION

The judgment of the circuit court of appeals was entered on July 3, 1944 (R. 181–182). The petition for a writ of certiorari was filed on October 2, 1944. The jurisdiction of this Court is

invoked under Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTION PRESENTED

Taxpayer, a domestic corporation, granted patent licenses to a British corporation in consideration of royalties based on the licensee's sales. The British law imposes a tax upon the local licensee measured by its gross profits or gains, without deduction for royalty payments, and authorizes the licensee to withhold from royalties paid a sum representing the tax thereon.

The question is whether amounts withheld by the licensee from 1935 royalties and paid as part of the British tax assessed against it are "taxes paid" by taxpayer to a foreign country, within the meaning of Section 131 (a) of the Revenue Act of 1934.

STATUTE AND REGULATIONS INVOLVED

Revenue Act of 1934, c. 277, 48 Stat. 680:

> SEC. 131. TAXES OF FOREIGN COUNTRIES AND POSSESSIONS OF THE UNITED STATES.
>
> (a) *Allowance of Credit.*—If the taxpayer signifies in his return his desire to have the benefits of this section, the tax imposed by this title shall be credited with:
>
> (1) *Citizen and Domestic Corporation.*—In the case of a citizen of the United States and of a domestic corporation, the amount of any income, war-profits, and excess-

profits taxes paid or accrued during the taxable year to any foreign country or to any possession of the United States;

* * * * *

(e) *Proof of credits.*—The credits provided in this section shall be allowed only if the taxpayer establishes to the satisfaction of the Commissioner (1) the total amount of income derived from sources without the United States, determined as provided in section 119, (2) the amount of income derived from each country, the tax paid or accrued to which is claimed as a credit under this section, such amount to be determined under rules and regulations prescribed by the Commissioner with the approval of the Secretary, and (3) all other information necessary for the verification and computation of such credits.

* * * * *

Treasury Regulations 86, promulgated under the Revenue Act of 1934:

ART. 131–2. *Meaning of terms.*—The "amount of any income, war-profits, and excess-profits taxes paid or accrued during the taxable year" means taxes proper (no credit being given for amounts representing interest or penalties) paid or accrued during the taxable year on behalf of the taxpayer claiming credit. * * *

ART. 131–3. *Conditions of allowance of credit.*—* * * If credit is sought for taxes already paid the form must have

attached to it the receipt for each such tax payment. If credit is sought for taxes accrued, the form must have attached to it the return on which each such accrued tax was based. This receipt or return so attached must be either the original, a duplicate original, a duly certified or authenticated copy, or a sworn copy. * * *

* * * * *

STATEMENT

Taxpayer, a New York corporation, owned British patents relating to the manufacture of airchutes and parachutes. In 1926, it granted to a wholly-owned English subsidiary an exclusive license to manufacture and sell to the British Government. The consideration for the license was the payment of £15,000 and a royalty of ten percent of the sale price of every airchute sold. By mutual agreement in 1933, the royalty was increased to twelve percent. (R. 144.) In 1935, the taxable year involved, the licensee sold airchutes at an aggregate price of $946,218.33,[1] upon which the twelve percent royalty amounted to $113,546.20. From this royalty, the licensee deducted and withheld the sum of $25,547.88, pursuant to Schedule D and General Rule 19 (2) of the British Income Tax Act of 1918, as

[1] For convenience, all figures will be expressed in American dollars.

amended.[2] The English company rendered to taxpayer monthly accounts showing gross royalties, the amount withheld therefrom as tax, and the net royalties. The net royalties for 1935 amounted to $87,998.32. The amounts withheld were entered on taxpayer's journal as "British tax paid at source." (R. 144–145.)

---

[2] Section 1 of the British Income Tax Act of 1918, 8 and 9 Geo. V, c. 40, as amended, provides that income taxes shall be charged—

> in respect of all property, profits, or gains respectively described or comprised in the schedules marked A, B, C, D, and E, contained in the First Schedule to this Act and in accordance with the Rules respectively applicable to those Schedules.

Section 1 of Schedule D designates as subject to the tax—

> (a) The annual profits or gains arising or accruing * * * (iii) to any person, whether a British subject or not, although not resident in the United Kingdom, from any property whatever in the United Kingdom, or from any trade, profession, employment, or vocation exercised within the United Kingdom; and (b) All interest of money, annuities and other annual profits or gains not charged under Schedule A, B, C or E and not specially exempted from tax * * *". R. 147–148.)

Rule 3 (m) of the rules applicable to Schedule D provides (R. 150):

> 3. In computing the amount of the profits or gains to be charged, no sum shall be deducted in respect of * * * (m) any royalty or other sum paid in respect of the user of a patent * * *.

General Rule 19 (2), stipulated to be applicable in this case, provides (R. 150):

> Where any royalty, or other sum, is paid in respect of the user of a patent, wholly out of profits or gains

On January 8, 1937, pursuant to Schedule D of the British Income Tax Act of 1918 as amended, the licensee paid to the British Inland Revenue Collector taxes aggregating $83,132.48, based upon the amount subject to the British tax for the calendar year 1935. This amount was the profit as shown by the licensee's profit and loss statement for 1935 plus the gross twelve percent royalty accrued to taxpayer during 1935 which had been deducted on the licensee's books but which was not an allowable deduction for tax purposes. Thus there was included in the amount of tax paid by the English company the $25,547.88 withheld by it from the gross royalty. (R. 145–146.) On its federal income tax return for 1935, taxpayer reported as income the twelve percent gross royalty, in the amount of $113,546.20. Attached to its return was the form for claiming credit

---

brought into charge to tax, the person paying the royalty or sum shall be entitled, on making the payment, to deduct and retain thereout a sum representing the amount of the tax thereon * * *.

General Rule 21 (1) provides (R. 150):

Upon payment of any interest of money, annuity, or other annual payment charged with tax under Schedule D, or of any royalty or other sum paid in respect of the user of a patent, not payable, or not wholly payable out of profits or gains brought into charge, the person by or through whom any such payment is made shall deduct thereout a sum representing the amount of the tax thereon at the rate of tax in force at the time of the payment.

under Section 131 of the Revenue Act of 1934 for taxes paid to a foreign country, on which taxpayer claimed the sum of $25,547.88 (the amount withheld and paid by the English company as British taxes) as taxes paid by it to Great Britain; of that amount it claimed $25,347.53 as a credit against its income tax due to the United States after application of the limitation upon such credit specified in Section 131 (b). The Commissioner denied the claim for credit, and determined that taxpayer's reported income from royalties should be reduced to the net amount actually received from the English company, or $87,998.82. (R. 146–147.) The Tax Court concluded (R. 154) that the British tax in question was "a tax levied upon, assessed against, and paid by the English company," and sustained the Commissioner's determination (R. 159). The circuit court of appeals affirmed, one judge dissenting (R. 181–182).

ARGUMENT

1. The decision below does not, as taxpayer alleges (Pet. 9–11), conflict with the decision of this Court in *Wisconsin Gas and Electric Co.* v. *United States*, decided May 29, 1944, No. 565, October Term, 1943. Rather, it finds additional support in that decision. This Court, distinguishing *Biddle* v. *Commissioner*, 302 U. S. 573, which is here controlling, held that even though the taxpayer corporation had collected and paid the

Wisconsin privilege dividend tax by withholding it from dividends paid to its stockholders, it could not deduct the tax as "taxes paid" within the meaning of Section 23 (c) of the Revenue Act of 1934 because the tax was "imposed" upon the shareholders, not upon the corporation. Here, the British tax was neither imposed upon nor collected from taxpayer. It was, as the Tax Court found, "a tax levied upon, assessed against, and paid by the English company" (R. 154). The instant case thus presents even more justification for denying credit to taxpayer under Section 131 (a) for foreign "taxes paid".

2. There is no merit in taxpayer's contention (Pet. 11–14) that the court below misapplied the decision of this Court in *Biddle* v. *Commissioner*, 302 U. S. 573. In the *Biddle* case, notwithstanding that the British law regards stockholders receiving dividends as having paid, by deduction, the "standard" (normal) tax which that law imposes upon and collects from the corporation, this Court held that a domestic stockholder was not entitled to credit under Section 131 (a) of our Act for foreign "taxes paid". Similarly, as the court below held, although there is language in the English cases to support the view that under British law, a patentee is regarded as having paid, by deduction, the taxes which that law imposes upon and collects from the licensee, the domestic patentee has not "paid" the British tax. This is so because, as this Court stated in

the *Biddle* case (p. 581), our revenue law does not treat as taxpayers "those upon whom no legal duty to pay the tax is laid." See also *F. W. Woolworth Co.* v. *United States,* 91 F. 2d 973, 975 (C. C. A. 2d), certiorari denied, 302 U. S. 768. Cf. *Welch* v. *St. Helens Petroleum Co.,* 78 F. 2d 631 (C. C. A. 9th). Taxpayer here, like the taxpayer in the *Biddle* case, was under no legal duty to pay the British tax, and did not pay it. *Dalgety & Co., Ltd.* v. *Commissioners of Inland Revenue,* 15 British Tax Cases 216. Even one from whom the tax is collected has not "paid" it within the scheme of our Act unless the tax has also been "imposed" upon him. *Wisconsin Gas and Electric Co.* v. *United States, supra.*

The dissenting opinion below (R. 180–181), upon which taxpayer relies (Pet. 18), cites no conflicting decision but is grounded on the theory that, unlike the relationship existing between a corporation and its stockholders, a licensor and licensee have conflicting economic interests. We submit that, at most, this factor serves only to establish the irrelevant proposition that the economic burden of the British tax was ultimately borne by taxpayer. It does not aid taxpayer's claim to a credit for foreign "taxes paid", for the *Biddle* case (p. 581) rejects the view that the tax is "paid" within the meaning of Section 131 (a) by the one who ultimately bears its burden. The holding of the court below (R. 178)

that the credit is allowable only to domestic taxpayers who are "directly liable" for the foreign tax is in complete harmony with the principles enunciated by this Court in the *Biddle* case and in the *Wisconsin Gas and Electric Co.* case.

3. Although taxpayer alleges (Pet. 18) that a question of importance in the administration of the tax law is presented, we are aware of no other instance in which a domestic licensor has challenged on appeal the applicability of the principles laid down in the *Biddle* case more than six years ago, nor has taxpayer cited any. In what appear to be the only two Tax Court decisions, besides that in the instant case, involving the issue here presented, that Court decided the issue against the licensor, and although an appeal was taken in each of those cases, it was taken on other issues. *Trico Products Corp.* v. *Commissioner,* 46 B. T. A. 346, affirmed on another issue, 137 F. 2d 424 (C. C. A. 2d), certiorari denied, 320 U. S. 799; *International Standard Electric Corp.* v. *Commissioner,* 1 T. C. 1153, affirmed and modified on another issue (C. C. A. 2d), August 11, 1944 (1944 C. C. H., par. 9442). And the fact that the court below took the view, contrary to that taken in *Crawford Music Corp.* v. *Commissioner,* 40 B. T. A. 284, that no different result would have followed if the British licensee had withheld and paid the British tax pursuant to General Rule 21 (1) rather than, as it did, under

General Rule 19 (2) (see *supra* note 2), is no reason for further review here, for whether payment of the British tax under Rule 21 or some other rule would have required a result different from that reached by the court below is an issue not here involved. Concededly, the decision below does not conflict with any decision by any other circuit court of appeals.

CONCLUSION

The decision in this case is controlled by the decision of this Court in *Biddle* v. *Commissioner,* 302 U. S. 573, and the decision below is in full accord with the ruling in that case. There is no conflict of decisions. The petition for a writ of certiorari should therefore be denied.

Respectfully submitted.

CHARLES FAHY,
Solicitor General.
SAMUEL O. CLARK,
Assistant Attorney General.
SEWALL KEY,
J. LOUIS MONARCH,
HARRY BAUM,
Special Assistants to the Attorney General.

OCTOBER 1944.

U. S. GOVERNMENT PRINTING OFFICE: 1944

(17)

Office - Supreme Court, U. S.
FILED
NOV 3 1944
CHARLES ELMORE CROPLEY
CLERK

IN THE

Supreme Court of the United States

October Term, 1944.

IRVING AIR CHUTE COMPANY, INC.,
Petitioner,
against
COMMISSIONER OF INTERNAL REVENUE,
Respondent.

No. 533.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT.

PETITIONER'S REPLY TO RESPONDENT'S BRIEF IN OPPOSITION.

RALPH M. ANDREWS,
DANIEL G. YORKEY,
Counsel for Petitioner.

BATAVIA TIMES, LAW PRINTERS,
BATAVIA, N. Y.

INDEX.

PAGE

Argument 1
Reply to Respondent's Points 1-2 1
Reply to Respondent's Point 3 6
Conclusion 9

CITATIONS.

Cases:

Biddle v. Commissioner, 302 U. S. 573 .....2, 5, 6, 9
British Salmson Aero Engines, Ltd. v. Commissioners of Inland Revenue, [1938] 2 K. B. 482 3
Commissioners of Inland Revenue v. Dalgety & Co., 15 Tax Cases 216 4
Constantinesco v. Rex, 11 Tax Cases 730 3
Crawford Music Corp. v. Commissioner, 40 B. T. A. 284 8
International Standard Electric Corp. v. Commissioner, 1 T. C. 1153 (1943), affirmed and modified on another issue, 144 F. (2d) 487 (C. C. A. 2d, 1944)..7, 8
Lanston Monotype Corporation, Ltd. v. Anderson, 5 Tax Cases 675 3
Trico Products Corp. v. Commissioner, 46 B. T. A. 346 (1942), affirmed on another issue, 137 F. (2d) 424 (C. C. A. 2d, 1943), certiorari denied 320 U. S. 799 (1943) 7, 8
Wild v. Ionides, 9 Tax Cases 392 3
Wisconsin Gas & Electric Co. v. United States, ... U. S. ...., 64 Sup. Ct. 1106 .....2, 5, 6

United Kingdom Statutes:

Finance Act, 1907 Sec. 25 3

PAGE

Income Tax Act, 1918

General Rule 19(1) 4
General Rule 19(2) 3, 4, 8
General Rule 21 ..... 4, 8
General Rule 21(1) 3, 8
Schedule D, Sec. 1 3

Rulings:

1940-1 C. B. 2 8

IN THE

Supreme Court of the United States

October Term, 1944.

IRVING AIR CHUTE COMPANY, INC., *Petitioner,* against COMMISSIONER OF INTERNAL REVENUE, *Respondent.*	No. 533

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT.

PETITIONER'S REPLY TO RESPONDENT'S BRIEF IN OPPOSITION.

Argument.

1-2. Respondent's brief in opposition proceeds upon a single erroneous premise which, if corrected, permits the case to be seen in its proper light.

Counsel says: "Here, the British tax was neither imposed upon nor collected from taxpayer" (Respondent's Brief, p. 8.) Of course, accepting this statement as true, counsel

then reasons that the *Wisconsin* case (*Wisconsin Gas & Electric Company v. United States*, ... U. S. ...., 64 Sup. Ct. 1106 (October Term, 1943, No. 565, May 29, 1944)) and the *Biddle* case (*Biddle v. Commissioner*, 302 U. S. 573 (1938)) fall into a pattern supporting his position. In the *Wisconsin* case, this Court, relying upon the decisions of the Wisconsin Supreme Court, found that the Wisconsin Privilege Dividend Tax "is imposed upon the shareholder, not upon the corporation", and hence that the claimed deduction was not available to the corporation. In the *Biddle* case, this Court, relying upon the English cases, found that the United Kingdom does not subject *dividends* to normal tax, and hence that the claim for credit was not available to the American shareholders of the English company.

Thus, the crux of this case is: Upon whom is the United Kingdom tax on patent royalties imposed?

Respondent relies solely upon a finding of the Tax Court that the tax in question was "a tax levied upon, assessed against, and paid by the English Company" (R. 154). The confusion and uncertainty with which the Tax Court viewed the problem are shown by its finding, *in direct conflict with that upon which respondent relies*, that "In the view of the United Kingdom Law a recipient of patent royalties from whom there has been withheld a sum representing the amount of the tax thereon is deemed to have paid a tax on such royalties by deduction." (R. 152.)

Aside from this confusion, the difficulty with respondent's position and with the statement of the Tax Court upon which he relies is that the British statutes and cases

are precisely to the contrary. Both General Rule 19 (2) and General Rule 21 (1) describe the sum to be withheld as "the amount of the tax thereon", *i. e.*, on the royalties paid. In *Lanston Monotype Corporation, Ltd. v. Anderson*, 5 Tax Cases 675 (1911) (Petitioner's Exhibit 19) Lord Justice Kennedy stated: "It seems to me * * * the true view is * * * that the object of the Section is to provide *for the tax on payment of the royalties by deduction.*"* (R. 49; Petitioner's Exhibit 19, p. 684.) It is pointed out in the petition for certiorari (p. 12) that Schedule D. Section 1, of the United Kingdom Income Tax Act, 1918, taxes all income derived from "any property whatever in the United Kingdom"; that income from royalty agreements relating to British patents is income from such property; and that *failure of the payor to deduct the tax upon payment of the royalty allows the Crown to make a direct assessment against the payee.*[1] *Wild v. Ionides*, 9 Tax Cases 392 (1925) (Petitioner's Exhibit 15); *Constantinesco v. Rex*, 11 Tax Cases 730 (Petitioner's Exhibit 16).

Much of the expert witness's testimony is directed to this point (R. 50, 51, 52, 59, 60, 78, 83, 84, 87, 88). His testimony may be summed up in the following excerpt (R. pp. 56, 57; fols. 168, 169):

> "In the view of the English law there is a fundamental difference between the tax deducted by a Company on the payment of a dividend and the tax deducted on the payment of patent royalties. A shareholder in a

* All italics ours except as otherwise indicated.

[1] Prior to 1907 United Kingdom tax on patent royalties was not collected by deduction at the source, but was directly assessed against the recipient of the royalies (R. 42). Section 25 of the Finance Act, 1907, which instituted collection by deduction at the source, made no change in substantive liability for the tax, but was simply a procedural provision for improving collection. *Lanston Monotype Corporation, Ld.* v. *Anderson*, 5 Tax Cases 675 (1911) (Petitioner's Exhibit 19) (R. 48, 49); *British Salmson Aero Engines, Ltd.* v. *Commissioners of Inland Revenue*, [1938]2 K. B. 482 (Respondent's Exhibit E) (R. 52, at 54).

> Company is not liable to Standard rate British Income Tax in respect of dividends * * * In the case of royalties, however, the recipient is charged as a taxpayer with the tax in respect of the royalty. *If the licensee does not deduct the tax the recipient can be assessed. If the licensee does deduct the tax he does so as a collector on behalf of the Crown and must account to the Crown.*"

None of this is challenged by respondent except to cite, as did the Tax Court, *Commissioners of Inland Revenue v. Dalgety & Co.*, 15 Tax Cases 216 (Respondent's Exhibit C), as if that case were to the contrary. The difficulty with such an interpretation of that case is that *it did not involve royalties at all.* It involved interest, which is controlled by a totally different rule—Rule 19(1), rather than Rule 19(2) or Rule 21. Rules 19(1) and 19(2) are mutually exclusive; Rule 19(1) has no application to royalties. (R. 60, 70, 136.)

Moreover, the *Dalgety* case arose under a special relief section of the statute which has no bearing on the United Kingdom tax law as a whole. (R. pp. 112, 113, fols. 336, 337.) And, perhaps most important, as Judge Learned Hand pointed out in his dissenting opinion below (R. 181; 143 F. (2d) 256, at 260-261), and as even a reasonably careful reading of the *Dalgety* case will disclose, the case was misread and misapplied by the Tax Court. Lord Justice Warrington characterized the tax as "*a tax payable by the recipient*" (R. 110, 111), and Lord Hanworth said: "*The tax deducted is the tax that is due from the person to whom the interest is paid*". (R. 102.)

These passages demonstrate that the issue presented by this case does not admit of the offhand, superficial treat-

ment which respondent has given it. They also demonstrate that counsel may not safely take refuge in a finding of the Tax Court that is not only without foundation in the record but is squarely in conflict with other findings of the Tax Court. Regardless of whether questions of foreign law are technically law or fact, it is plain that *they are not questions as to which the Tax Court has any special competence.*[2]

If effect is given to the record and the United Kingdom law, it will be clear that liability for the tax is upon petitioner. This being so, it follows that the decision below conflicts in principle with the decision of this Court in the *Wisconsin case*, and that it is not justified by the decision of this Court in the *Biddle* case.

In the *Biddle* case this Court held that since the United Kingdom income tax was collected out of the common pool of corporate earnings, it could not be said that an individual stockholder receiving dividends from which "the tax appropriate thereto" had been deducted had herself "paid" the tax for purposes of credit. In the *Wisconsin* case, on the other hand, where the tax reached not into the common pool but into the stockholder's individual allotment from the pool, this Court, citing the *Biddle* case as a decision to be distinguished, held it was imposed upon the stockholder and should be regarded as "paid or accrued" by him.

---

[2] All facts in this case are stipulated (R. 15 *et seq.*). The evidence as to the British law consists of the undisputed and self-consistent testimony of an English barrister specializing in income tax matters (R. 35 *et seq.*) together with pertinent British statutes and cases which, though not printed in the record, were received in evidence and have been physically transmitted to the Clerk of this Court pursuant to stipulation.

In the instant case the British tax falls not upon a common fund, but upon the individual recipient of royalties. The parallel to the *Wisconsin* case and the distinction from the *Biddle* case are clear.

3. Respondent's third point (Brief, pp. 10, 11) does not meet the position taken in Point II (p. 18) of the petition, or the reasons there advanced why the question which this Court is asked to review is of importance in the administration of the revenue laws.

Respondent states that he is not aware of any other instance "in which a domestic licensor has challenged *on appeal* the applicability of the principles laid down in the *Biddle* case * * *." (Brief, p. 10.) This entirely misses the point. To petitioner's knowledge there are many contested proceedings involving the precise issue which this case presents. They have not reached the Circuit Court of Appeals because they are being held to await the outcome of this case. Most of them have not even reached the Tax Court, in some instances because the taxpayer has simply executed a waiver of the statute of limitations on assessment pending the outcome of this case, in other instances because the tax has already been paid and the question arises on claim for refund. Although we have been in correspondence with taxpayers' attorneys throughout the country with regard to many such cases, and although we have reason to believe that there are others which have not been brought directly to our attention, we are not at liberty to refer specifically to all of them. We are authorized

to state, however, that in the cases listed in the footnote [3] a similar issue is pending.[4]

Respondent does say that the issue here presented was involved in *Trico Products Corp. v. Commissioner*, 46 B. T. A. 346 (1942), affirmed on another issue, 137 F. (2d) 424 (C. C. A. 2d, 1943), certiorari denied 320 U. S. 799 (1943), and in *International Standard Electrict Corp. v. Commissioner*, 1 T. C. 1153 (1943), affirmed and modified on another issue, 144 F. (2d) 487 (C. C. A. 2d, 1944). In both cases, however, the issue here presented was of negligible important to the taxpayer compared with the other

---

[3] *Chicago Bridge & Iron Company*—Claims for refund for years 1933-1938 now pending before Commissioner of Internal Revenue—Claims for refund to be filed covering years 1939-1943.

Charles A. Kaufman v. Commissioner of Internal Revenue, Board of Tax Appeals Docket No. 95992—Case held in abeyance pending final determination of *Irving Air Chute Company v. Commissioner of Internal Revenue*.

Tampax, Incorporated—Claim for refund filed for year 1938 and disallowed by Commissioner of Internal Revenue. Protest will be made and suit for refund will be instituted. Claims for refund covering years 1939-1941 will be filed.

William Wrigley, Jr. Company—Claims for refund filed for years 1930-1937 and disallowed by Commissioner of Internal Revenue. Agreement entered into between taxpayer and Commissioner of Internal Revenue on July 15, 1943, suspending the running of the statute of limitations on disallowed claims for refund pending a final determination of *Irving Air Chute Company v. Commissioner of Internal Revenue*. Claims for refund for years 1940-1943 have not been filed pending final determination of *Irving Air Chute Company v. Commissioner of Internal Revenue*.

[4] Counsel for respondent has not denied petitioner's statement (Petition, p. 18) that there are a "large number of cases now pending which will turn upon and be controlled by the outcome of the instant case". In view of respondent's knowledge of the facts, this may properly be taken as an admission that petitioner's statement is correct.

issues involved, and we are advised [5] that for this reason the issue was not raised on appeal.

Respondent dismisses the conflict between the decision in this case and the decision of the Board of Tax Appeals in *Crawford Music Corporation v. Commissioner*, 40 B. T. A. 284 (1939), on the ground that in the *Crawford* case withholding occurred under Rule 21 (Respondent's Brief, pp. 10, 11). This is not a sufficient answer. The general rules are not charging sections; they are simply procedural sections providing the machinery for collection of the United Kingdom tax (R. 44, 49). Petitioner reports its income on the accrual basis (R. 20). The issue whether petitioner is entitled to credit for United Kingdom tax withheld from royalties due petitioner depends upon the fact of liability for the tax, and the general rules are not an aid in determining that question. At the time the United Kingdom tax accrued, the British payor of royalties could not know whether it would have gains or profits for the year or not; hence it could not know whether it would withhold under General Rule 19(2) or under General Rule 21(1). Conflict with the *Crawford* case (in which the Commissioner

[5] With regard to the *Trico* case, a letter in our file, dated October 19, 1942, and signed by Arthur A. Ballantine, Esq., counsel for the taxpayer in that case, refers to the foreign tax credit issue presented in the instant case and states in part: "In the Trico case * * * this particular point is of trifling importance as compared with the principal question as to liability under Section 102." A subsequent letter from George C. Cleary, Esq. of Mr. Ballantine's office states in part "* * * we did not spend much time investigating the British tax credit point as it was obvious that it could not be argued in brief compass * * *." "* * * we needed the entire 50 pages allowed for the brief * * * to deal with the Section 102 question, which is of overwhelming importance * * *."

With regard to the *International Standard Electric* case, Allin H. Pierce, Esq., counsel for the taxpayer in that case, wrote us under date of September 16, 1944, with reference to the issue presented by the present case: "An issue of that nature was, incidentally, involved in one of my cases, *International Standard Electric Corporation*, 1 T. C. 1153, but as the issue was of minor importance we did not attempt to introduce all of the necessary evidence on the point but relied largely on your case. The Tax Court decided the point against us; and in our appeal to the Circuit Court of Appeals for the Second Circuit, the point was dropped entirely."

has acquiesced (1940-1 C. B. 2) and which he has followed administratively) is complete. To assert that there is no conflict is to say that the credit will be allowed when the British payor has no profits or gains for the year under the unique definition of the United Kingdom Law, but that it will not be allowed when the British payor does have such profit or gains. This would make the credit under our statute depend upon the vagaries of the United Kingdom law—a result which this Court in the *Biddle* case clearly stated would not be tolerated.

Conclusion.

For the reasons set out herein and in the petition previously filed, a writ of certiorari to the Circuit Court of Appeals for the Second Circuit to review its decision in this case should be granted.

Respectfully submitted,

RALPH M. ANDREWS,
DANIEL G. YORKEY,
Counsel for Petitioner.

(18)

Office - Supreme Court
FILED
NOV 3 19
CHARLES ELMORE CR
OF

IN THE

Supreme Court of the United States

OCTOBER TERM, 1944

No. 533

IRVING AIR CHUTE COMPANY, INC.,
Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF SUBMITTED BY *AMICUS CURIAE*

MITCHELL B. CARROLL,
Amicus Curiae.

October 31, 1944.

INDEX

PAGE

INTRODUCTORY STATEMENT 1

ARGUMENT:

1. Under the criterion in *Biddle* v. *Commissioner,* an American recipient of royalties taxed by the deduction of the standard rate of tax at the source in Great Britain is a taxpayer entitled to the credit for such tax under section 131, Internal Revenue Code 2

2. Refusal to allow the credit for the British tax in this case would nullify the relief from double taxation intended by the Congress of the United States 10

3. The judgment of the Circuit Court should be reviewed and reversed: The dissenting opinion of Judge Hand should be adopted by this Court 13

CONCLUSION 15

Citations

CASES

Biddle *v.* Commissioner, 302 U. S. 573; 58 S. Ct. 379 ..... 1, 2, 3, 4, 9, 10, 12, 13

The Commissioners of Inland Revenue *v.* Dalgety & Co. (1930), 1 K. B. 1; 46 T.L.R. 349; 15 Tax Cases (British) 216 14

The Commissioners of Inland Revenue *v.* Sangster (1920), 1 K. B. 587; 12 Tax Cases 208 7

Constantinesco *v.* Rex, 43 T.L.R. 727; 11 Tax Cases 730 8

Webb Press Co., Ltd., 3 BTA 247 6

Wild *v.* Ionides, 9 Tax Cases 392 8

United States Statutes and Regulations

PAGE

Internal Revenue Code:

Sec. 13 4
Sec. 14 4
Sec. 23(a) 6
Sec. 131 ..... 1, 2, 12, 13
Sec. 131(a)(1) 10, 15
Sec. 131(b) 10
Sec. 131(h) 15
Sec. 143 5
Sec. 143(b) 5, 14
Sec. 143(c) 5, 14
Sec. 144 ..... 5, 14
Sec. 231 4
Sec. 231(a) 4, 5
Sec. 235(b) 4
Revenue Act of 1918 10
Revenue Act of 1934 10
Revenue Act of 1936 ..... 4, 6

Regulations:

Reg. 94, art. 143-2 4
Reg. 111, sec. 29.143-2 4
Reg. 111, sec. 29.235-2(a) 5

United Kingdom Statutes

Income Tax Act, 1918 6
Income Tax Act, 1918, Schedule D, sec. 1 6
Income Tax Act, 1918, Schedules A, B, C, D, and E 7
Finance Act of 1927, sec. 26 7
Finance Act of 1927, sec. 39 8
Rule 3(m) applicable to cases I and II of Schedule D 8
General Rule 19 (2) 8
General Rule 21 ..... 3, 7, 13
General Rule 23 9

Miscellaneous

PAGE

Collection of International Agreements and Internal Legal Provisions for the Prevention of Double Taxation and Fiscal Evasion, League of Nations, Geneva 11

House Report 767, 65th Congress, 2nd session, Revenue Bill of 1918, 7308, vol. 2, p. 11 11

E. M. Konstam, The Law of Income Tax, 9th ed., 1943, London 8

IN THE

Supreme Court of the United States

OCTOBER TERM, 1944

IRVING AIR CHUTE COMPANY, INC., *Petitioner,* v. COMMISSIONER OF INTERNAL REVENUE, *Respondent.*	No. 533.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF OF *AMICUS CURIAE*

Introductory Statement

This brief *amicus curiae* is filed pursuant to the consent of counsel in the case at bar.

Our interest in this case arises from the fact that a large number of taxpayers normally deriving royalties, or other income similarly taxed (*e.g.* interest), from British corporations are being denied the credit for foreign taxes under section 131, Internal Revenue Code, because of the application of the decision of this Court in *Biddle* v. *Commissioner,* 302 U. S. 573; 58 S. Ct. 379, to royalties and interest, as well as dividends from British sources to which class of income alone that decision related. Tax-

payers deriving the same categories of income from other countries, which impose taxes "at the source" more or less in accordance with the model of the British system of collection, might also lose their credit for such taxes if an adverse decision is rendered by this Court. The corporations concerned are represented through the Tax Committee of the National Foreign Trade Council, Inc., and it is in their behalf that I respectfully submit this brief.

ARGUMENT I

Under the criterion in *Biddle* v. *Commissioner*, an American recipient of royalties taxed by the deduction of the standard rate of tax at the source in Great Britain is a taxpayer entitled to the credit for such tax under section 131, Internal Revenue Code.

The primary purpose of this brief is to show that, even if the criterion prescribed by this Court in *Biddle* v. *Commissioner, supra,* which involved only dividends, is applied in this case involving royalties, the licensor receiving royalties from a British corporate licensee pays the tax within the meaning of our own statute. In the words of this Court, the question as to whether the recipient of the income pays the tax "must ultimately be determined by ascertaining from an examination of the manner in which the British tax is laid and collected what the stockholder (in this case the licensor) has done in conformity to British law and whether it is the substantial equivalent of payment of the tax as those terms are used in our own statute". (302 U. S. 573, at 579; 58 S. Ct. 379, at 382.)

The sole issue to be decided in this case is a very definite one, namely, whether the sum of $25,547.88 with-

held from royalties otherwise due the American company, and paid instead to the British Government, were taxes accrued or paid by the American company. These payments were in essence just that. They were certainly, to use Justice Stone's expression, the "substantial equivalent" of taxes levied upon and collected from the American company out of its income derived from sources in the United Kingdom.

More specifically, this brief will endeavor to show that an American corporate licensor receiving royalties from a British corporate licensee is just as much a taxpayer under the British law as a British corporation would be regarded as a taxpayer if it received royalties from an American corporate licensee.

The resort to the machinery of collection at the source does not change this essential. It simply reflects the obvious fact that

> "the person by or through whom any such payment is made"

(see Rule 21, *infra*, p. 7) is more easily amenable to collection machinery than is the American company. This is a common incident in the taxation of income accruing in one jurisdiction in favor of non-resident nationals of another. The selection of a collection remedy *in rem*, where the remedy *in personam* is of doubtful efficacy, need not cause confusion. The duty of the foreign recipient of income to make a contribution to the revenues of the realm is clear. The elaborate inquiry in the *Biddle* opinion into the operation of the collection machinery seems to detract from this clarity, rather than assist in keeping a correct view of the issue.

The *Biddle* decision was rendered January 10, 1938, barely a year and a half after the system of collection at source was introduced in the Revenue Act of 1936 (approved June 22, 1936), in the case of dividends, interest, royalties and other fixed or determinable annual or periodical income derived from United States sources by non-resident aliens and foreign corporations not engaged in trade or business in the United States. The provisions involving corporations were in section 231 of that act and, with an immaterial amendment, they appear under the same section number in the Internal Revenue Code (hereinafter referred to as I.R.C.), as follows:

> "Sec. 231. Tax on Foreign Corporations
>
> (a) Nonresident Corporations.—
>
> (1) Imposition of Tax.—There shall be levied, collected, and paid for each taxable year, in lieu of the tax imposed by sections 13 and 14, upon the amount received by every foreign corporation not engaged in trade or business within the United States, from sources within the United States as *interest* (except interest on deposits with persons carrying on the banking business), *dividends, rents,* * * * *or other fixed or determinable annual or periodical gains, profits, and income,* a tax of 30 per centum of such amount * * *" (italics ours).

Royalties are included in the term "fixed or determinable annual or periodical income" (Regulations 94, relating to the income tax provisions in the Revenue Act of 1936, art. 143-2; Regulations 111, relating to the income tax under the Internal Revenue Code, sec. 29.143-2).

Ordinarily the taxpayer's liability is satisfied by the tax withheld at source and such a foreign corporation has no further responsibility, as is shown by section 235 (b),

I.R.C., which provides that "Subject to such conditions, limitations, and exceptions and under such regulations as may be prescribed by the Commissioner, with the approval of the Secretary, corporations subject to the tax imposed by section 231 (a) may be *exempted* from the requirement of filing returns of such tax" (italics ours).

Section 29.235-2 (a), of Regulations 111 relating to the income tax under the Internal Revenue Code, further clarifies this point by stating that "if the tax liability of a nonresident foreign corporation is fully satisfied at the source a return of income is not required."

The requirement for withholding tax at the source is found in section 144, I.R.C., which provides that "In the case of foreign corporations subject to taxation under this chapter not engaged in trade or business within the United States, there shall be deducted and withheld at the source in the same manner and upon the same items of income as is provided in section 143 a tax equal to 30 per centum thereof, * * * and such tax shall be returned and paid in the same manner * * *."

The reference to section 143 envisages paragraph (b) of that section, which states that:

> "All persons, in whatever capacity acting, * * * having the control, receipt, custody, disposal, or payment of interest * * *, dividends, * * * or other fixed or determinable annual or periodical gains, profits, and income (but only to the extent that any of the above items constitutes gross income from sources within the United States), of any nonresident alien individual * * * shall * * * deduct and withhold from such annual or periodical gains, profits, and income a tax equal to 30 per centum thereof * * *."

Section 143 (c) requires the person who deducts and withholds tax to make a return thereof and pay the tax to

the competent official and, to assure payment, such person is made liable for such tax and indemnified against the demands of the recipient of the income.

Royalties paid by a licensee are deductible from gross income as ordinary and necessary business expenses under section 23 (a), I.R.C., and it has been specifically so held in the case of royalties paid to a stockholder for use of patents (*Webb Press Co., Ltd.*, 3 BTA 247).

In short, the United States tax is imposed upon royalties received by a British corporation not engaged in trade or business within the United States and the corporate licensee is required to withhold the tax from the royalty, make a return and pay the amount withheld to the Collector of Internal Revenue. The corporate licensee may deduct the amount of the royalty from its gross income.

Even when liability of the foreign corporate licensor is thus satisfied at the source, and the licensor does not itself deliver a check or cash, there is still no doubt that the foreign corporate licensor is the "taxpayer" under our law.

The provisions in the United Kingdom Income Tax Act, 1918, as amended, relating to the taxation of patent royalties paid by a British corporate licensee to an American corporate licensor are comparable to those set forth above. In fact, they served more or less as a pattern for the system of withholding at source adopted in our own Revenue Act of 1936.

Under Schedule D of the United Kingdom Income Tax Act, 1918, section 1 provides that:

> "Tax * * * shall be charged in respect of—
>
> "(a) The annual profits or gains arising or accruing—
>
> * * * * * * *

(iii) to any person, whether a British subject or not, although not resident in the United Kingdom, from any property whatever in the United Kingdom * * *."

The term "profits * * * from any property" in the above provision includes income from royalty agreements (*The Commissioners of Inland Revenue* v. *Sangster*, [1920] 1 K. B. 587; 12 Tax Cases 208).

Under Rule 21 of the General Rules applicable in the case of Schedules A, B, C, D and E of the United Kingdom Income Tax Act, 1918, as amended by the Finance Act of 1927, section 26, it is specifically provided that:

"(1) Upon payment of any interest of money, annuity, or other annual payment charged with tax under Schedule D, or of any royalty or other sum paid in respect of the user of a patent, not payable, or not wholly payable out of profits or gains brought into charge, the person by or through whom any such payment is made shall deduct thereout a sum representing the amount of the tax thereon at the rate in force at the time of payment.

"(2) Where any such payment as aforesaid is made by or through any person, that person shall forthwith deliver to the Commissioners of Inland Revenue, for the use of the Special Commissioners, an account of the payment, or of so much thereof as is not made out of profits or gains brought into charge, and of the tax deducted out of the payment or out of that part thereof, and the Special Commissioners shall assess and charge the payment of which an account is so delivered on that person."

Notwithstanding this provision for collection, it is quite clear that the liability is that of the licensor, and this is proven by the fact that if the payor fails to deduct the tax

upon payment, the Crown may make a direct assessment against the payee (Konstam, The Law of Income Tax, 9th ed., p. 177, citing *Wild* v. *Ionides*, 9 Tax Cases 392; *Constantinesco* v. *Rex*, 43 T.L.R. 727; 11 Tax Cases 730).

If the royalties are paid out of profits or gains that are taxable, a slightly different machinery of collection is provided, but it in no way alters the fact that the tax is imposed on the recipient of the royalty or that such recipient is the intended taxpayer under the law. Rule 19 (2), as amended by the Finance Act of 1927, section 39, provides that, where any royalty, or other sum, is paid in respect of the user of a patent, wholly out of profits or gains brought into charge to tax, the person paying the royalty or sum shall be entitled, on making the payment, to deduct and retain thereout a sum representing the amount of the tax thereon at the standard rate for the year in which the amount payable becomes due.

To complete the machinery of collection at source and get the amount of the tax into the Treasury, the corporate licensee is required to add back the amount of the royalty to his profit "brought into charge" (Rule 3(m), Rules applicable to Cases I and II of Schedule D). This device of increasing the amount collected from the licensee is the substantial equivalent of payment of the tax by the licensor as those terms are used in our statute.

In short, there is no essential difference between the English method of collection of tax at the source from royalties paid by a British corporate licensee to a nonresident corporate licensor and the American method of collecting royalties derived by a British licensor from sources in this country. The British law ordinarily applies the same standard rate to the income of the corporation and to the royalty paid by the corporation to the licensor.

If the corporate licensee has no profits, it withholds the tax in *exactly* the same manner as an American corporate licensee. If it has profits, the corporate licensee includes the royalty with the profits subject to the standard rate and then collects the corresponding tax from the licensor by withholding the standard rate from the royalty. The tax is actually, therefore, paid by the licensor who is liable thereto under the general charging provision of Schedule D quoted above (pp. 6, 7).

Surely, it is apparent that where the royalty is paid by a corporate licensee not out of its taxable income, the British system is the exact equivalent of the American system of taxation at source. To hold that the tax is not paid by the American corporate licensor where the royalty is first subjected to the standard rate at the same time as the profits, and then is paid to the licensor after deduction of the standard rate, would have the effect of introducing a discrimination in British taxation that has obviously never been intended.

The United Kingdom Act makes the corporate licensor liable, and considers the licensor to be the taxpayer just as much as does the United States law. The proof of such liability is found in Rule 23, General Rules, which provides:

> "(1) A person who refuses to allow a deduction of tax authorised by this Act to be made out of any payment, shall forfeit the sum of fifty pounds.
>
> "(2) Every agreement for payment of interest, rent, or other annual payment in full without allowance of any such deduction shall be void."

The standard set by Justice Stone in the *Biddle* decision is summed up in the following sentence (302 U. S. 573, at page 581) where, referring to our laws, he says:

> "nor have they [our revenue laws] treated as taxpayers those upon whom no legal duty to pay the tax is laid".

We submit that from the foregoing it is clear that both in the United States and in England, a duty *is* laid upon the foreign recipient of royalties to pay a tax upon them. Therefore, he is by the criterion set in the *Biddle* case "the taxpayer"—quite irrespective of the precise operation of the collection machinery.

ARGUMENT II

Refusal to allow the credit for the British tax in this case would nullify the relief from double taxation intended by the Congress of the United States.

The very language of section 131 (a)(1), I.R.C., clearly reveals the intent of the Congress of the United States that said provision should be so construed as to prevent the double taxation of income derived by a domestic corporation from a foreign source. Section 131 (a)(1) provides, subject to the limitation in subsection (b), that the tax imposed by title I of the Revenue Act of 1934 shall be credited with "In the case of * * * a domestic corporation, the amount of *any* income, war-profits, and excess-profits taxes paid or accrued during the taxable year to any foreign country * * *" (italics ours).

Obviously, Congress intended to give a domestic corporation relief in respect of *any* foreign income tax which reduced income received by the corporation. The relief provision was introduced in the Revenue Act of 1918 in order to help restore American commerce with foreign

countries after World War I through obviating the paralyzing burden of having to pay taxes in respect of the same income both in the foreign country of its source and again in the United States, at rates which together often amounted to more than the income involved. (See House Report 767, 65th Congress, 2nd session, Revenue Bill of 1918, 7308, Vol. 2, p. 11.) By means of this unilateral measure, the United States accomplishes essentially what numerous other countries accomplish by exemptions or allowances in their tax laws or in more than fifty bilateral conventions.*

Recognizing the fact that income taxes differ in form from country to country, the Congress stipulated that the credit should be accorded in respect of *any* income taxes paid to *any* foreign country. We believe this is the intent, quite irrespective of whether the tax was directly assessed on the taxpayer or collected by deduction at source, as in the United Kingdom. That country has followed the method of collection of income tax at source for over a hundred years.

Collecting tax by this method does not alter the fact that the tax itself is regarded by the United Kingdom as a personal tax on the recipient of the income. The collection at source is applied by withholding wherever possible the standard rate from such income as dividends, royalties, annual interest and other annual payments.

Especially where the recipient, as in this case, is by contract to receive a fixed amount which is reduced by the tax, there can be no doubt that the recipient is the taxpayer under the British law. This fact has long been recognized by the Bureau of Internal Revenue. To re-

* Collection of International Agreements and Internal Legal Provisions for the Prevention of Double Taxation and Fiscal Evasion, League of Nations, Geneva.

verse this practice, upon which taxpayers have so long relied, will not only subject the taxpayer in the present case to great hardship but will also subject many others to deficiency assessments and increased levies.

While this Court in the *Biddle* decision felt impelled to regard a tax paid in the first instance by a British company on its profits as equivalent to our corporation tax, it should be constrained, by virtue of its own test of applying domestic criteria, to reach a different conclusion in regard to royalties. Under our own law, royalties are an allowable deduction as a business expense, and they are so regarded in British law, except as pointed out above in one case for the purpose of taxation at source. Our device of taxing royalties paid to a foreign corporate licensor by withholding at source should be acknowledged as having its counterpart in the British system.

The withholding of tax at the source under our system does not alter the fact that the tax is imposed on the nonresident corporate licensor which receives the royalties, and the same is true under British law.

Refusal to regard the American corporate licensor receiving royalties from a British company as the taxpayer for the purpose of the credit under section 131, I.R.C., would be as much of a distortion of the British law as to hold that a British corporate licensor receiving royalties from an American corporation was not the taxpayer under our law.

The system of collection at source has been adopted by many other countries, which, like the United Kingdom, regard the recipient as the taxpayer, but consider his liability satisfied when the tax has been withheld by the payor of the income and delivered to their respective treasuries. A decision unfavorable to the taxpayer in this

case would not only result in denying the credit for the United Kingdom tax withheld from royalties and also interest, but might in addition cause the United States Treasury to disallow the credit for taxes withheld from similar income in other countries. Such a decision of this Court would so seriously impair the relief from double taxation intended by the Congress as to discourage appreciably the resumption of foreign commercial activities of domestic enterprises after the current hostilities cease.

ARGUMENT III

The judgment of the Circuit Court should be reviewed and reversed: the dissenting opinion of Judge Hand should be adopted by this Court.

In the light of the comparison of the American and British machinery for collection at source, and the Congressional intent of relief from double taxation under section 131, I.R.C., we believe that the dissenting opinion of Judge L. Hand of the Circuit Court, 143 F. (2d) 256, at 260, is the correct view of this issue. He sees the British law in the proper perspective when he points out in substance that there should be no doubt that the patentee would be paying the tax when the licensee withholds the tax under Rule 21 (*i.e.*, when the royalty is not paid out of profits brought into charge), and that it would be "absurd * * * to say that the patentee pays the tax, according to whether the licensee is himself taxed upon enough 'profits or gains' to equal the royalties he has paid".

Judge Hand is absolutely justified in emphasizing that the *Biddle* decision relates only to dividends and "a patentee and his licensee are * * * persons in conflicting interest, unlike a corporation and its shareholders; the tax in the end comes out of the patentee's pocket, not out

of the licensee's, whatever the form." (*Irving Air Chute Co., Inc.* v. *Commissioner*, 1 T. C. 880; 143 F. (2d) 256.

In citing *The Commissioners of Inland Revenue* v. *Dalgety* [1930], 1 K. B. 1; 46 T.L.R. 349; 15 Tax Cases 216, the majority of the Circuit Court below overlooked the true import of that House of Lords decision. While holding that the company literally paid the United Kingdom tax on income from Australia and New Zealand, which had been taxed there and was therefore entitled to the relief from double taxation allowed under the United Kingdom Income Tax Act, the House of Lords stated that, "having paid, the Company was entitled to deduct that tax from the debenture interest, and, to the extent of that deduction, *it was the debenture-holders' tax that was thus discharged*", 15 Tax Cases 216, at page 245 (italics ours). The operation of the British law was even more graphically described by the Court of Appeal, *ibid.*, at page 232, whose decision was upheld, in the statement, "the company is a taxpayer and has to pay income tax on its profits before deductions and * * * *the person entitled to the yearly interest of money is also a separate taxpayer independently liable to pay his tax.*" This applies also to royalties.

There is no essential difference between such a payment and one made under sections 143(b) and 144, I.R.C., which require all persons paying royalties to a foreign corporation not engaged in business in the United States to deduct and withhold a tax equal to 30 per centum of the amount of the royalty, and section 143(c), which requires said persons to make a return and pay the tax to the authorized official.

The reasoning of the majority opinion of the Circuit Court to the effect that the taxpayer's royalty contract is

by British law "made so elastic that the licensee is permitted to reduce the amount of petitioner's income receivable as royalties under it" merely serves to dispose of a tax that cannot otherwise be explained away. It is to be hoped that this honorable Court will not permit to stand such a judicial nullification of a tax which, in accordance with the above decision of the House of Lords, is clearly the tax of the licensor.

Contrary to the surmise of the majority of the Circuit Court as to the intent of Congress, its intent is so liberal that it not only allows the credit for *any* income tax under subsection (a)(1) of section 131, I.R.C., but also for a "tax paid in lieu of a tax upon income * * * otherwise generally imposed by any foreign country * * *", under section 131(h). Certainly this manifestation of the generous intent of Congress would justify the Court in upholding the minority opinion in the present case.

Conclusion

The Court is therefore urged to grant the petitioner's prayer that a writ of certiorari be issued to the United States Circuit Court of Appeals for the Second Circuit to review a judgment of that Court in the above case entered on July 3, 1944 (R. 181), affirming a decision of the Tax Court of the United States (R. 160) that there is a deficiency in the income tax of the petitioner for the calendar year 1935.

Respectfully submitted,

MITCHELL B. CARROLL,
Amicus Curiae.

October 31, 1944.